APPORTIONMENT OF INCOME.

IN the management of a trust fund there often arise questions of apportionment of income. The subject is not a large or important one. It seldom gives cause for litigation. In some form or other however the question comes up every day. It arises whenever a trust account is closed. And at such times it is necessary, and at other times often convenient, to run over the whole subject and apply the law to the various investments contained in some trust or other fund. Sometimes one has to audit an old trust account, and the staleness of the facts in such a case causes questions of apportionment to arise in forms difficult to answer. While the problem may merge into questions between capital and income, it is ordinarily distinct from them, and its concrete form is not "Is this income?" but "Whose income is this?"

The old idea that rent or income came due not from day to day, but all at once when it could be collected, was the product of the uncertainties of its time. The modern trend, the result of modern certainties, has made the conception of income something which is earned from day to day, — a reward for daily abstinence, as the economists would say. And wherever income comes in regularly enough to make it possible, the tendency to-day is to apportion it as a matter of equity unless some special difficulty exists.

The question should always be approached from a reasonable point of view. Accountants will frequently urge one to refine upon it and reduce it to a mathematical question. Over-conservative trustees will constantly be inclined to apply an unintelligent rule of thumb for their own convenience. Between these two extremes, it would seem that the rule of law should be based upon the kind of accounting which a prudent business man, thoroughly up to date in methods of audit and account, would employ as to his own investments.

The question may arise

I. Between buyer and seller.
II. At the commencement of a trust or fund.
III. On purchase or sale for a trust account.
IV. At the end of some life or other interest in a fund.

I. Buyer and Seller.

Questions often arise about the division or apportionment of the income or profits of a thing bought or sold. Of course, if the parties think of the point at the time, they are likely to cover it; but often they do not, and often, as in stock-exchange transactions, they are in a hurry and prefer to leave the point to the general rule of law or to some particular custom. In buying and selling, then, the rule of apportionment is purely one of conventionalized intention. But it is valuable in connection with the other questions to be discussed later, because the question for decision in cases which call for the application of such a rule, is often whether and when the income in question has ceased to be an incident of the principal thing. And the discussion of such a question turns upon general principles of apportionment. Common specific cases are:

Rent. — This passes by a grant of the lessor's interest, unless overdue. But where that grant puts an end to a tenancy at will, the seller loses his portion of the rent.[1]

Taxes. — These become a lien and incumbrance on a day certain (in Massachusetts May 1st). A mere transfer of the seller's interest after that day leaves the lien on the buyer. For the land is the true debtor for the tax, and the liability of the owner is only secondary.[2]

Insurance. —This does not pass as incident.

Usually, however, rent, taxes, and insurance are apportioned by special agreement, as may be seen by consulting any common blank form for the purchase and sale of real estate.

Coupons. — Where a bond is not in default, the purchaser gets the current unpaid coupon. Where it is in default, he gets all unpaid coupons unless special circumstances exist. There are two customary ways of quoting prices for bonds, "flat" and "and interest." "Flat" means that a lump sum is paid for the bond, coupon on; "and interest" means that the price is settled, and in addition accrued interest is adjusted *pro rata*. In a place, if any exists, where neither custom is known, I presume a sale where nothing was said would be assumed to be a sale "flat." In the New York Stock Exchange prices are "flat," in the Boston Stock

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[1] Hammond *v.* Thompson, 168 Mass. 531.

[2] Swan *v.* Emerson, 129 Mass. 289.

Exchange "and interest," which leads to some differences commented on later in this article. "On the Curb" in New York the sales are "and interest." For obvious reasons bonds in default are presumed to be sold "flat," even when the general custom is otherwise.

INTEREST. — Interest not represented by a coupon or specialty passes as incident to the debt in the absence of agreement.

DIVIDENDS. — These "go off" or cease to pass as incident on the day of declaration, unless the corporation fixes a day for them to go off by voting that they are to be paid to stockholders who were or shall be such on a fixed day. In such a case this day, if after declaration of the dividend, governs.

II. INCOME ACCRUED AT THE COMMENCEMENT OF A TRUST.

A conveyance, devise, or bequest of specific investments must be interpreted to ascertain whether accrued income is intended to be conveyed to the life tenant or beneficiary. In the absence of any evidence of such intention some general rule should be applied. And it would seem fair, if there is no expression to the contrary, to suppose that a person, who owns an income-producing investment and conveys or devises it, has in mind, by the use of the word "income," that which he knows will be the increment of the fund. A giver by deed should not in fairness, and a giver by will cannot, turn Indian giver and demand back something which passes naturally as incident to the gift. Nor is there any reason to believe that such a giver intends to capitalize what is in its nature income.

The law is that any specific or residuary gift carries with it income from the date of conveyance or death. The income is not to be deferred to the date when the estate is or ought to be settled. While the law is clear, executors are not accurate about this, and a trustee taking over assets from an executor (or where trustee and executor are one, some representative of the life tenant) will generally get a fairly profitable result from overhauling the executor's account on this point.

It should be noted, however, that a life tenant who is entitled to the income of a residue from the date of death is entitled, according to some decisions, only to the income of the net residue, and not to the income of the gross residue. Where the debts are small, this rule calls for inconvenient and annoying accounting with no

profitable result, but in a large and involved estate it would seem to be necessary and just that the life tenant should bear in some form the interest on the debts which balance and have probably enabled the purchase of the investments. The rule stated in the cases is that such a portion of the capital as with its income for one year will pay debts, legacies, and charges, shall be applied to that end, and the remaining portion or fraction of the principal is the net trust capital, while the remaining fraction of income and no more is the net or true trust income.[1]

This rule was applied to a case where the residue produced 15% income, and where therefore the life tenant would have preferred to be charged with the debts as of the day of death, and get the margin of 9% or more over the statutory rate of interest. Generally, of course, the statutory rate is greater than the trust rate and the life tenant gains slightly.[2]

An annuity charged on the residue is chargeable on the income of the residue from the first. But it would seem that a direction to purchase an annuity is a legacy of the cost, and in the absence of a contrary intention should be treated as if payable at the time when other legacies are due.

All income which is due and payable at the date of a death — that is to say, such matters as in the case of a sale would not pass as incident to the thing sold — becomes part of the principal. This rule generally works some hardship, and it should be guarded against in drawing wills where the difficulty is likely to arise. In the case of a husband who leaves his property in trust for his wife, there ought to be, in addition to the gift in trust, an outright legacy of a sum sufficient to represent the amount of income which a prudent woman should have on hand as a working balance. The average testator has cash in bank which is income, and does not mean to capitalize it. The writer knows of one case where the money upon which a husband and wife expected to live for the ensuing year was technically in hand at the date of the husband's death and so was capitalized. The result was to cripple the widow's finances severely, just when the contrary would have given needed ease and comfort.

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[1] Allhusen *v.* Whittell, L. R. 4 Eq. 295 (1867).

[2] Lambert *v.* Lambert, L. R. 16 Eq. 320 (1873).

III. Apportionment in the Purchase and Sale of Investments during the Trust.

In general, wherever income would pass with a thing sold or come with a thing bought, it is held that it is lost to, or gained by, the life tenant when the trustee sells or buys.

A prudent trustee ought, however, so to frame his bargains that injustice will not be done to either party; and where, as in Massachusetts, the test of his duty and power is his reasonableness and prudence, it would seem that he ought to be upheld in so framing his accounts that the substance of the transaction will be there represented fairly.[1]

Suppose that one should desire to-day to sell for a trust a block of the first mortgage bonds of the so-called "Atchison" railroad. These are freely dealt in in New York and in Boston on the Exchanges. In New York they sell "flat;" in Boston, "and interest." The best way to sell such bonds is to give a broker an order to sell for a fixed price and interest, and to authorize him to execute the order through his representatives in either Exchange, giving it to each according to the custom of his Exchange, but at substantial equivalents. Thus the advantage of both markets is obtained. On a block of $10,000 the difference between a sale "flat" the day before and the day after the coupon is due will make a difference to the life tenant of $200, if no apportionment is made. And it would seem clear that whichever way a sale is made it ought to be apportioned and settled in the trust accounts as a sale "and interest." Guaranteed stocks, income bonds, and other like securities ought to be treated in the same way. The writer is informed, however, that the practice (where there is anything definite enough to deserve the name) is often otherwise; and that some prominent trustees even instruct their brokers to return to them only the net sale, or purchase "flat," whatever the form of the transaction with the other party. This is done, perhaps, because of the economy of bookkeeping, as it reduces the three entries of principal, commission, and interest to one. The result in any particular case seems grossly unfair, and the writer has heard of a case where a trustee designedly

[1] Compare New England Trust Co. *v.* Eaton, 140 Mass. 532, where a testamentary trustee without special powers in the will was sustained in apportioning bond premiums between capital and income.

sold stocks and bonds flat just "ex dividend" or coupon, and bought others flat just before dividend or coupon day with the express purpose of favoring the life tenant. On the other hand, in ten years of accounting by an honest trustee the net result would probably balance, and it would not be worth while to disturb his accounts.

A like point arises where rights accrue to stock to subscribe at a profit to other stock. The rights themselves, if sold, are capital. However, if they should be sold and new stoek of the company bought with the proceeds, dividends would begin at once. If the trustee subscribes under them a delay occurs and he commonly loses two dividends before he gets full stock on the new subscription. It would seem fair that the equivalent of the lost dividends, or at least interest on the money which is not producing dividends, should be paid to the life tenant and charged up as part of the cost of new stock. So far as the writer knows of any practice in trust accounts, it is the other way. The stock market, however, faithfully represents this fact in comparative values. That is to say, the investor pays at least enough less for the rights than for the equivalent stock to balance this loss of dividends.

A point, perhaps chiefly of interest between principal and income, is worth speaking of under this head because of the question when the thing, if income, falls due. In the reorganization of more than one western railroad some interest, at least, was earned on first mortgage bonds during the receivership, but was applied to capital expenditures, and a part of the new securities given at the reorganization in exchange for old ones was specifically declared to be in exchange for coupons overdue.

In the Atchison "Plan" of 1895, page 3, the Adjustment Bonds are declared to be given (to the extent of 40% of the principal of old General Mortgage Bonds) in adjustment as follows: "25% for balance of principal of the General Mortgage Bonds (only 75% was given in new General Mortgage Bonds). 8% for accrued interest to July 1, 1895. 7% as compensation for reduction of fixed charge, and the non-cumulative feature for five years." The footnote giving this detail does not appear in all copies of the plan which the writer has seen, but the text states that "the coupons on the present General Mortgage Bonds are funded to July 1, 1895" (p. 3), and calls for the deposit of bonds with coupons representing interest from July 1, 1893 (p. 19); and from these two statements the same inference must be drawn. The St. Joseph & Grand Island Ry.

plan of 1896 gives 25% face value second preferred stock of the new company in return for coupons on old firsts. The old bonds bore interest at 6%, and were paid interest up to Nov. 1, 1893. The new bonds, bearing 2–3–4%, bore interest from Jan. 1, 1897, at the rate of 2% for the first two years. The loss was coupons for a face value of 19%. The new second preferred stock had not any considerable market value. That is to say, in the one case valuable adjustment bonds, in the other second preferred stock was given to the security holder in respect of, and because of income which had been impounded for purposes of the reorganization. The Boston trustees about whose action the writer has known sold eight-fortieths of the Atchison Adjustment Bonds received, and paid the proceeds to the life tenant. What, however, should have been the course of a trustee whose life tenant died pending the reorganization? The old coupon interest became due from day to day, and was apportionable (see below); but it was not paid except as part of the general settlement of the reorganization. When did it accrue as income? As the coupons became due? On deposit (when other interest was adjusted in cash)? When the plan became operative? It would seem that here, as some of the older members of the Suffolk Bar sometimes reply to their juniors, "The answer to those questions is a bill for instructions."

In the case of a compromise of a claim involving interest and principal, it would seem that a trustee ought to take a set of present value tables at the fair rate of trustee interest, fix the date or dates when the money ought to have been paid, ascertain the sum which then invested would have produced the amount received and divide *pro rata* the interest among the persons entitled to the income of the intervening period.[1]

If the interest in the claim ran at 6% there might be a case for adjusting interest at that rate. Another mode is to make up the claim at its face values of principal and interest, and divide the settlement money in like proportions.

IV. Apportionment at the End of Life Interest.

The real problem in apportionment is met on the death of the life tenant when a mixed fund has to be considered. The adjuster should have before him a memorandum of dates and facts, *e. g.*, "John Doe died June 1, 1902, at 9 A.M., having a life interest

[1] Maclaren *v.* Stauiton, L. R. 11 Eq. 382.

under a trust fund, created by will (or deed) on April 1, 1860, by Richard Roe. The exact language creating the life estate is," etc.

FORMS OF INCOME IN QUESTION. — Interest grows due from day to day and is apportionable.[1] But an exception is made where the interest is represented by a separate specialty, *e. g.*, a coupon.[2] It is not then apportionable at common law.

Where the coupons are in ordinary form, at common law they are not apportionable.[3]

In Massachusetts, prior to Jan. 1, 1902, coupons were apportionable if in a trust created by will, but not if in a trust otherwise created.[4]

The Revised Laws removed this anomaly Jan. 1, 1902.[5] *Quaere* as to whether the dates of the statutes or the date of the instrument should determine.

COUPONS NOT IN USUAL FORM. — Atchison Adjustment Bonds[6] may be taken as an example. The interest is cumulative. No interest is payable except when and as declared in October by the directors out of a year's business ending July 1. It is clear that there is no certainty of any declaration of interest, nor that at the date of the death of the life tenant any net earnings exist and are applicable which may not be swept away by subsequent net losses. It would seem then that where the life tenant dies after July 1, the interest is fixed and should go to his estate, while if he dies before July 1, it is at least uncertain whether his estate can claim anything.

Kansas City, Memphis & Birmingham Income Bonds furnish another illustration. This mortgage defines net earnings, and requires payment of interest out of them, with a proviso or condition subsequent that the directors shall adjudge the earnings to be sufficient, and authorize the payment. It would seem that this is in the nature of a dividend, and not apportionable if declared, after a life tenant's death, for a period during part of which he was not living. The interest is not cumulative. Since the guarantee of these coupons by the St. L. & S. F. Ry. Co., it would seem that they are like other bonds.

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[1] Dexter *v.* Phillips, 121 Mass. 178.

[2] Clark *v.* Iowa City, 20 Wall. 583–589; Dexter *v.* Phillips, 121 Mass. 178; Adams *v.* Adams, 139 Mass. 449. In Massachusetts otherwise by statute cited below.

[3] Clark *v.* Iowa City, 20 Wall. 583–589.

[4] Pub. St. c. 136, sec. 25, enacted May 10, 1848, as c. 310, sec. 2 of A. & R. of 1848.

[5] See R. L. c. 141, § 25. [6] The mortgage is in Com. & F. Chronicle, 62, p. 739.

DIVIDENDS. — *General Provisions.* — The decisions of the courts have dwelt on and given importance to the dates of four circumstances.

1. Date of declaration.
2. The specific period, and especially the date of its end, in respect of which payment is made, *e. g.*, "for the quarter ending July 1st."
3. The date when a dividend "goes off" the stock, *i. e.*, the date after which a transfer does not carry the dividend as incident to the stock.
4. Date of payment.

It is specially to be noted that these facts may occur in almost any order of time.

1. The date of declaration is always obtainable, although sometimes after lapse of time hard to get at except on the corporate records.

2. In the case of a cumulative preferred stock not in arrear one can be certain of the period in respect of which it is declared. But elsewhere this is often impossible, the directors simply declaring "a dividend" and designedly omitting the period (perhaps because in what would naturally be the period they did not earn the dividend declared). In such cases one can sometimes get a pretty definite statement of the real period at the office of the company. Dividends on preferred cumulative stock in arrears are sometimes declared in respect of the earliest period as to which there are arrears, sometimes in respect of the current period; and sometimes (as if to plague the trustee) as simply "a dividend."

3. The dividend goes off the stock as between buyer and seller as soon as declared, unless the company in its declaration fixes a date on which it shall go off. Sometimes this date is previous to the declaration, in which case it does not go off until declaration. In auditing old accounts it is sometimes hard, without access to corporate records, to get the date when the dividend goes off.

4. Dividends may be declared to be paid at the treasurer's convenience, but they are generally declared to be payable on a day certain. Sometimes after such declaration (perhaps to avoid an injunction) the treasurer is authorized to, and does anticipate payment.

If the life tenant dies prior to the declaration and prior to the

end of the period, or if no such period is named, the remainder-man gets the whole dividend.[1]

If the life tenant dies (1) after the declaration but (2) before the end of the period (3) before the date when the dividend goes off and (4) before payment, it would seem clear that his estate cannot have the whole dividend, because a portion of the period for which the dividend was declared was after his death. Justice would seem to suggest that it be apportioned. But apportionment of dividends in the absence of statute may be difficult, even where as in this case they have ceased to be uncertain. It would seem more likely that the remainder-man would get the whole, partly on the grounds urged in Foote Appellant,[1] partly because the dividend is payable to stock which at the important times has come to be owned by the remainder-man, and partly because it is at the date of death still uncertain. Payment of the dividend may fail or be enjoined.

If the declaration is in respect of a definite period ending before death, this fact is controlling. The declaration itself and other matters may all be after death. This was decided in Johnson Ex'or *v.* Bridgewater Co.[2]

This decision would seem to apply to arrears on cumulative dividends, and to income bonds where the income period is fixed, and to be much broader than is generally assumed.

The absence of a specific period presents more difficulties. Suppose such a dividend declared January 1, then the life tenant's death January 15, the dividend payable to stock of February 1, and payable March 1, and no specific period named in respect of which it is to be paid. This would seem to be *debitum in praesenti solvendum in futuro*, and to be probably, although doubtfully, the life tenant's. If the death were February 15th there would be little or no doubt that it was the life tenant's.

The general rule is that the dividend goes to the holder at the date of declaration. The application of these suggestions and rules to cumulative income bonds or preferred stocks will produce some astonishing results. For instance, a life tenant may die in 1890 and if arrears of preferred stock dividends are heavy and are paid up first, the remainder-man may not get anything for ten years or so. If current dividends are paid first, the administrator of the life tenant may get a plum ten years or so after his intestate has died.

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[1] Foote Appellant, 22 Pick. (39 Mass.) 299, 304. [2] 14 Gray, 274.

And how are he and the trustee to settle their respective accounts until the transaction is over?

RENT. — Rent is not apportionable at common law.[1] In Massachusetts the statute above cited makes it apportionable. In the usual case rent grows due from day to day or is for an annual period. But what is one to say to a Bar Harbor or Newport lease with rent payable June 1 and September 1, when every one knows that in substance the whole year's rent is earned between June 1 and October 1? In such a place a lease for sixteen months — say the period from June 1, 1902, to Oct. 1, 1903 — can be and sometimes is written reserving two years' rent. Should a life tenant who dies May 1, 1903, eleven months after the beginning of the term, but before the second season, have eleven-sixteenths of the rent for the two seasons?

In England rent payable in advance is not apportionable.[2] The Massachusetts statute would seem to provide that it is, and certainly all income paid in advance for a specific period ought to be held to be apportionable over that period. The question, of course, is — what will happen to the trustee if he pays the life tenant immediately on receipt, as he often does? The answer is, he ought not to pay immediately.

PROFITS OF BUSINESS. — Partnership articles usually contain a withdrawal clause and a settlement clause. Where trustees are authorized to be partners they ought certainly, where feasible, to adjust the articles so that they will be fair in the event of the death of a life tenant. All withdrawals payable should represent the fair and certain increment from week to week or month to month, and withdrawals payable before the death should go to the life tenant. The profit-taking period ought to be a fair one (yearly generally because of the effect of seasons on profits), and extra profits or losses ought to be reckoned as accruing at that time. Any excess of withdrawals over accruing profits, except such as is accidental, ought to be stopped at once.

OUTGO. I. *Taxes.* — In Massachusetts taxes are not apportionable. They accrue May 1st in respect of the following twelve months,[3] and should be charged to the person who is entitled to the income on that day.[4]

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[1] Com. Dig. Tit. Rent. Dexter *v.* Phillips, 121 Mass. 178.

[2] Ellis *v.* Rowbotham, [1900] 1 Q. B. 740.

[3] Inhabitants of Southborough *v.* Inhab. of Marlborough, 24 Pick. 166.

[4] Holmes *v.* Taber, 9 Allen (Mass.) 246 (1864).

As tax bills are not received or payable until autumn, a prudent trustee ought not to account with his life tenant during the summer without reserving a safe margin. It is respectfully submitted that the above ruling is archaic, and ought to have been covered by the statute which made rents apportionable, since rents and taxes are yearly and certain entries on one and the same account. The state of the law raises the question whether a trustee buying or selling taxable real estate ought to have the taxes apportioned to the date of transfer. That is the usual custom of prudent men. And if he had the power to apportion taxes on death, a trustee should follow that custom. The peculiar state of the law seems to work a hardship in permitting the life tenant to have the rents only up to the day of his death when he is required to pay the tax bills for the entire year if he is alive on May 1.

II. *Insurance.* — Insurance premiums are apportionable. This has the most obvious fairness. The death divides a term. The short rate for either part of it is greater than the fraction of the total rate. The risk exists and the protection is given from day to day.

III. *Repairs. Surety Company Bond Premiums, etc.* — These ought in fairness to be apportioned over the period during which they benefit the tenant. If this cannot be done with reasonable certainty, they must lie where they fall, like dividends. But such a result is unfair. The writer has known of a case where a surety company premium for taking out the bond of the trustee was greater than the subsequent annual payments to the company, and the excess greater than the first six months' income. It was wiser to pay this out of income at once than to pay for a bill for instructions, but a fair-minded trustee who had power to decide the question would have charged something to capital, or deferred charging it for a while.

Where a tenant pays anything in the nature of a fine for a lease, or where the landlord, as is often the case, abates rent for a period in consideration of repairs, it would seem that fair adjustments should be made, not only between principal and income where capital is involved, but also between periods of income. An abatement of six months' rent in order to get a three years' lease should be apportioned over the three years. An abatement of rent in order to get the tenant to do structural improvements of equal or greater value should be chargeable to capital.

General Conclusions.

Fortunately, the question of apportionment can be, and often is, disposed of by the construction of the instrument under which it arises. This is sometimes due to accident, and sometimes to the skill of the conveyancer.

The accidents happen when, generally at the end of litigation, it is established that a testator who made a specific bequest or devise of a wasting investment intended that the person entitled to the income at a particular time should have what was then received, whatever its nature. Such cases are simply questions of intention.

There are also cases where the draughtsman has decided beforehand, and laid down a rule of apportionment to be followed in administering the particular fund.[1]

Good draughtsmen now draw their trust instruments to give to the trustee the power to apportion as between life tenant and remainder-man, and it could at least do no harm to extend these clauses so as to cover also apportionment of income. It would seem that these powers are powers of appointment, and should be sustained as such. Still it is likely that some one will want to try the issue whether they do not make the trustee a referee or judge, and whether, in such case, they are so drawn as successfully to avoid the cases which decide that an agreement or direction to arbitrate is void.

Whether or no the will or instrument leaves the discretion to the trustee, it is submitted that the courts ought to do so so far as is practical. The question is one of fact. It is a question of how a prudent man would regard the matter. Investments are as various as can well be in these active days, and their variety results in many odd points and peculiarities of income and outgo. Those which are not peculiar are not the only safe ones for trustees. And once the question of safety is settled, the trustee of to-day ought to have a reasonably free hand. He is already allowed to apportion coupons in his discretion.[2] And this practice ought to apply to the whole general subject. Enough has been said to show that the refinements of the question present many and strange pitfalls for the unwary. Those refinements ought to be tempered with common

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[1] Hemenway *v.* Hemenway, 171 Mass. 42.

[2] New England Trust Co. *v.* Eaton, *supra.*

sense. The adjustments suggested ought to be made, or at least considered, when they are important. But a good trustee is not necessarily either a skilled professional accountant or a trust lawyer, and the writer has no intention to assert that he should be. The object of this article is to show that the question of apportionment is one upon which a trustee ought to be alert. It should never escape his mind, and he should use common sense about it.

Richard W. Hale.

BOSTON, MASS.